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**[4310-MR-P]**

**DEPARTMENT OF THE INTERIOR**

**Minerals Management Service**

**30 CFR Part 209**

**RIN 1010-AC51**

**Preliminary Royalty in Kind Regulations**

**AGENCY:** Minerals Management Service, Interior

**ACTION:** Proposed rule

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**SUMMARY:** The Minerals Management Service (MMS) is proposing to add a new Part to its regulations at 30 CFR 209 to apply when the Secretary of the Interior elects to take the government's royalty share of production from Federal oil and gas leases in kind. The proposed rule would not affect the existing regulation governing sales of Federal royalty oil to eligible refiners under 30 CFR Part 208.

The new Part 209 is proposed to provide a regulatory basis for several new royalty-in-kind (RIK) programs by which MMS intends to test the feasibility and examine the revenue effects of different ways of taking and disposing of RIK production. The regulation would provide general guidance on how we will proceed and what is expected of lessees and

operators when we elect to take the government's royalty share of production in kind.

**DATES:** Comments must be submitted on or before (Insert Date 60 days after date of publication in the Federal Register).

**ADDRESSES:** If you wish to comment, you may submit your comments by any one of several methods. You may mail comments to Bonn Macy, Special Assistant to the Director, Minerals Management Service, 1920 C Street, Room 4264, Washington, D.C. 20225. You may also comment via the Internet to RMP.comments@mms.gov. Please submit Internet comments as an ASCII file avoiding the use of special characters and any form of encryption. Please also include "Attn: RIN 1010-AC51" and your name and return address in your Internet message. If you do not receive a confirmation from the system that we have received your Internet message, contact Bonn Macy directly at (202) 208-3827.

**FOR FURTHER INFORMATION CONTACT:** Bonn Macy, Special Assistant to the Director, telephone (202) 208-3827, FAX (202) 208-3968, e-Mail: BonnMacy@mms.gov.

**SUPPLEMENTARY INFORMATION:** The principal authors of this proposed rulemaking are Mr. Eric Hager, Appeals Division, Minerals Management Service and Ms. Anne Ewell, Royalty Management Program, Minerals Management Service.

We will post public comments after the comment period closes on the Internet at <http://www.rmp.mms.gov>. You may arrange to view paper copies of the comments by contacting Bonn Macy, Special Assistant to the Director, Minerals

Management Service, (202) 208-3827, FAX (202) 208-xxxx. Our practice is to make comments, including names and home addresses of respondents, available for public review during regular business hours. Individual respondents may request that we withhold their home address from the rulemaking record, which we will honor to the extent allowable by law. There also may be circumstances in which we would withhold from the rulemaking record a respondent's identity as allowable by law. If you wish us to withhold your name or address, you must state this prominently at the beginning of your comment. However, we will not consider anonymous comments. We will make all submissions from organizations or businesses, and from individuals identifying themselves as representatives or officials of organizations or businesses, available for public inspection in their entirety.

#### **I. Background.**

The Department of the Interior has managed mineral leasing on Federal lands since the Mineral Leasing Act was passed in 1920 (30 U.S.C. 181, et seq (1994) (MLA). Under the terms of standard Federal oil and gas leases, the government is entitled to a share (royalty) of production removed or sold from the lease. The terms "in value" and "in kind" refer to the manner in which a mineral owner (lessor) receives the royalty share from the producer (lessee). Like most other royalty owners, the U.S. government has historically received its royalty share "in value", that is,

in cash as a percentage of the sales proceeds received by the lessee.

For most onshore Federal leases, the MLA provides in relevant part at 30 U.S.C. 192 that:

All royalty accruing to the United States under any oil or gas lease or permit under this chapter on demand of the Secretary of the Interior shall be paid in oil or gas.

For offshore leases, the Outer Continental Shelf Lands Act, as amended (OCSLA) provides in relevant part at 43

U.S.C. 1353(a)(1) (1994) that with some minor exceptions:

all royalties or net profit shares, or both, accruing to the United States under any oil and gas lease issued or maintained in accordance with this subchapter, shall, on demand of the Secretary, be paid in oil or gas.

Section 2 of a typical onshore Federal lease form provides in part that "Lessor reserves the right to specify whether royalty is to be paid in value or in kind." (October 1992, Form 3100-11). By section 6(d) of the offshore lease form, the lessor reserves "the right to determine whether royalty will be taken in the amount or the value of production." (February 1971, Form 3300-11).

Over the years, the Secretary's authority to take RIK has rarely been used. The only exception has been the RIK program that MMS currently operates for certain "eligible refiners" as authorized by specific provisions of the MLA at 30 U.S.C. 192 (1994) and the OCSLA at 43 U.S.C. 1353(b)(2) (1994).

As a general matter, the collection of royalties in cash as a percentage of the value of production has worked well in most cases. However as will be discussed below, there are a number of reasons that make it worthwhile now to examine whether the Government should receive at least some of its royalties "in kind" by taking physical volumes of oil or gas for sale to the public or for transfer to other federal agencies.

There are several reasons why this may be a good time to examine these options. First, dramatic changes in the energy industry have been occurring over the past 10 to 15 years that may present opportunities to MMS to provide greater certainty and simplify its royalty management programs. Rapidly changing market structures over this period have resulted in product price volatilities and the expansion of actively traded spot markets across the country. Traditional long-term contracts between producers and pipeline and refiner purchasers have been increasingly replaced by active short-term trading by new market participants, such as brokers and resellers.

Further, many sellers now regularly use futures markets for risk management and obtain real-time market information directly with personal computers and telecommunications links. These and other changes have created opportunities for enterprising producers to sell their production "downstream" closer to final consumers.

For natural gas, this has been facilitated by the Federal

Energy Regulatory Commission's (FERC) deregulation of the natural gas transportation industry and the evolving deregulation of retail natural gas and electricity markets.

Overall, these developments have combined to present new and challenging issues for Federal royalty management. In some cases, the task of auditing and accounting for in value based royalties is made even more complicated when lease production is marketed, transported and sold through the complex and wide variety of arrangements now commonly being used in oil and gas markets.

The challenges presented by evolving market structures and changing business practices also provide significant opportunities for us to try new and innovative ways to manage the oil and gas on behalf of the public. One of the ways MMS is responding to these challenges and opportunities is examining the RIK option.

On a number of occasions, members of Congress, representatives from industry, the public, and State and other Federal agencies have urged MMS to consider what advantages there may be to taking Federal oil and gas royalties in kind.

This interest has focused on a number of potential benefits. As an alternative to the accounting and auditing systems associated with the percent of proceeds based royalty program, a successfully targeted RIK program could provide greater certainty, administrative efficiencies, and other cost savings. Fulfillment of the royalty obligation

by the delivery of physical volumes of oil or gas could decrease the need for extensive reporting, verification, and auditing of lessee sales proceeds. This could lead to net economic benefits for industry as well as Government.

A second possible benefit is that, in select circumstances, taking product in kind and selling it at market prices might yield more revenues for the public than taking a percentage of a given lessee's sale price. In other cases, we might be able to take RIK and transfer it for fuel use to other Federal agencies and realize real savings in Federal energy costs.

In response to these possibilities and the interest in them, MMS has structured several pilot projects to demonstrate whether royalty revenues can be enhanced by taking royalties in kind. The agency has solicited participation from affected States and consulted with industry in their development. Through these pilot projects, MMS expects to gain a better understanding of the key factors that determine RIK success.

For example, we could find that an RIK option works best where leases have certain production characteristics, where regional markets or transportation arrangements are particularly suited to RIK or where different methods are used to market the production. Some production may be more appropriate for transfer within the government.

To this end, the several pilot projects are currently underway or are in planning for the next 2 to 3 years to

help us determine whether or not RIK is viable for the Federal Government, and, if so, how, when, and where it makes sense to exercise the RIK option.

#### General RIK Guidelines

The authorizing provisions of the MLA and the OCSLA and the relevant lease provisions effectively give the Secretary complete discretion to elect to take the royalty share of production from an oil and gas lease in kind. Both the MLA and the OCSLA also direct that RIK production so taken must be either sold to the public (including to eligible refiners) under certain prescribed terms or be retained or transferred to agencies of the Federal government.

For sale of onshore production to the public, the MLA provides in relevant part for public domain lands at 30 U.S.C. 192 that:

Upon granting any oil or gas lease under this chapter, and from time to time thereafter during said lease, the Secretary of the Interior shall, except whenever in his judgment it is desirable to retain the same for the use of the United States, offer for sale for such period as he may determine, upon notice and advertisement on sealed bids or at public auction, all royalty oil and gas accruing or reserved to the United States under such lease. Such advertisement and sale shall reserve to the Secretary of the Interior the right to reject all bids whenever within his judgment the interest of the United States demands; and in cases where no satisfactory bid is received or where the accepted bidder fails to complete the purchase, or where the Secretary of the Interior shall determine that it is unwise in the public interest to accept the offer of the highest bidder, the Secretary of the Interior, within his discretion, may readvertise such royalty for sale, or sell at private sale at



not less than the market price for such period, or accept the value thereof from the lessee: ....

For sales of offshore RIK oil to the public, the OCSLA provides in relevant part at 43 U.S.C. 1353(b)(1) that:

The Secretary, except as provided in this subsection, may offer to the public and sell by competitive bidding for not more than its regulated price, or, if no regulated price applies, not less than its fair market value, any part of the oil (A) obtained by the United States pursuant to any lease as royalty or net profit share, ....

For sales of offshore RIK gas to the public, the OCSLA also provides in relevant part at 43 U.S.C. 1353(c)(1) that:

Except as provided in paragraph (2) of this subsection, the Secretary, pursuant to such terms as he determines, may offer to the public and sell by competitive bidding for not more than its regulated price, or, if no regulated price applies, not less than its fair market value any part of the gas (A) obtained by the United States pursuant to a lease as royalty or net profit share, or (B) purchased by the United States pursuant to subsection (a)(2) of this section.

As can be seen, onshore RIK production may be retained by the government or offered for sale "upon notice and advertisement on sealed bids or at public auction." Offshore RIK production may be transferred for disposal within the federal government or offered to the public and sold "by competitive bidding for ... not less than its fair market value."

#### Offshore Fair Market Value

In addition to requiring competitive bidding procedures

for all sales of offshore RIK to the public, the OCSLA also directs that the production may not be sold for less than its "fair market value."

As a generic term, "fair market value" is generally considered by economists to be the price received by a willing and knowledgeable seller not obligated to sell from a willing and knowledgeable buyer not obligated to buy. For offshore RIK sales however, the OCSLA prescribes a very specific definition of that term. Section 1331(o) of 43 U.S.C. (1994) defines "fair market value" for purposes of RIK sales to be essentially the average unit price received for production from the same lease or in some circumstances from leases sold in the same region during the period.

The 43 USC 1331(o) (1994) definition is as follows:

The term "fair market value" means the value of any mineral (1) computed at a unit price equivalent to the average unit price at which such mineral was sold pursuant to a lease during the period for which any royalty or net profit share is accrued or reserved to the United States pursuant to such lease, or (2) if there were no such sales, or if the Secretary finds that there were an insufficient number of such sales to equitably determine such value, computed at the average unit price at which such mineral was sold pursuant to other leases in the same region of the outer Continental Shelf during such period, or (3) if there were no sales of such mineral from such region during such period, or if the Secretary finds that there are an insufficient number of such sales to equitably determine such value, at an appropriate price determined by the Secretary;

Under this statutory definition, the first applicable paragraph (1) of the provision seems to require that

offshore RIK production taken by the Secretary must be sold for at least as much as the average unit price for which the lessee sold the non-royalty share of production from that lease.

In cases where there were no other sales from the same lease or where the Secretary finds that there were an insufficient number of such sales to equitably determine such a value, the fair market value floor may be computed under the next paragraph (2). That paragraph provides that fair market value may be computed with reference to average unit prices in sales from "other leases in the same region." Finally if a value cannot be determined under paragraphs (1) or (2), an appropriate price may be determined by the Secretary.

In-value royalties are generally based on a percentage of the gross proceeds received by the lessee in his sales of all the production from a lease. When the Secretary elects to take the royalty share in kind and sell the offshore oil or gas, a strict reading of the "fair market value" definition seems to imply that the Secretary must obtain a return to the Government that is no less than what would have otherwise been paid as a percent of value royalty on that production.

For the reasons given below, it is our view that a literal application of paragraphs (1) and (2) of the definition would in most instances be unworkable and not likely to produce the "equitable" result that the statutory definition

apparently seeks.

First, in evaluating competitive bids for RIK production, MMS could not as a practical matter know the average prices of other sales from the same lease or from other leases in the region before they are observed. Strict conformance with paragraph (1) of the definition would require knowing at the time of the RIK sale what the lessees' actual sales prices were for the non royalty share of production from the lease. Application of paragraph (2) would also require instantaneous knowledge of the sales prices of other lessees in the region.

By law and regulation, however, this information is not reported by Federal lessees to MMS until the end of the month following the production month. (30 U.S.C. 1701-1757 (1988) and 30 CFR 210.52 (1997)). In most instances, we would never know the lessee sales prices until well after we had to sell the production. Further, sales price information reported by a lessee for a month may be corrected for as long as 6 years after the initial report. [CITATION].

Under either paragraphs (1) or (2), MMS would be obliged to reject any offer to purchase offshore RIK production for prices that fell below the average of lessees' contemporaneous sales prices.

In today's business environment, this process is simply not commercially or administratively feasible. It would impose potentially costly data collection and other

administrative burdens on both government and industry, and possibly expose a company's sensitive pricing information to competitors.

In theory, we could require that all RIK purchase prices be subject to post-sale adjustments when the reference lease information becomes available to MMS. In our view, this would be excessively burdensome to all concerned and would effectively discourage participation in RIK sales.

If bidders did participate, they would necessarily bid a lower price for the royalty production than they would otherwise because of the risk of post-sale adjustment, particularly if this adjustment could be made as much as 6 years after the actual sale. It is clear that such a process would not only be inequitable to potential purchasers, but could not effectively capture a fair market value as that term is conventionally understood. Again, there is the possibility that lessees' proprietary data would be unavoidably disclosed to purchasers through the post-sale adjustment process.

The substantial changes in the way oil and gas are bought and sold since OCSLA was enacted, could not have been anticipated by the drafters of that legislation.

In the context of the current commercial and market conditions, we have tried to come up with reasonable and more practical ways to meet the statutory "fair market value" requirement in implementing an offshore RIK program.

We would like your comments on one approach that we think

would be workable while essentially consistent with the statutory definition.

In advance of each sale of royalty oil or gas from identified Federal leases, MMS would establish a reference price for each specific lease that is consistent with the "fair market value" requirement that offshore RIK sales not be made for less than the price received by the lessee.

To establish this reference price, MMS would analyze the prices for sales in the area or market centers appropriate for sales of production from those leases. One source of data for the analysis would be actual MMS historical reported sales prices for the identified leases, or if none are available, from leases in the same area. Other data sources could include published index prices and bids MMS may have received on other offerings of its royalty oil or gas from that area.

On this basis, we would then compare reported prices on a selected lease (or if none are available, from those in the area) against indices and other factors that are being considered for use in valuing RIK. The analysis would tend to reveal the relationship between the lessees' price and the market. This relationship would form the basis for the lease's reference price.

Other factors that have an impact on prices such as responses to other sales of similar Federal royalty production, seasonality and other variable market conditions could also be considered in establishing this reference

*the fact that using a reserve price it is not in rule language.*

price. This price would serve as a reserve price, below which production would not be sold. To facilitate evaluation of bids submitted in a competitive sale, MMS would evaluate bids relative to the market prices used to help establish the reference price.

To verify that the relationship between lessees' sales prices and market prices continues, MMS proposes to require occasional reporting by lessees of sales prices on leases from which MMS is taking production in kind. These reported prices would be used for information and analytical purposes only.

We welcome any and all comments on this or other methods of operating an effective RIK program that would enable us to comply fully with the OCSLA fair market value requirement.

#### Transfer of RIK Oil and Gas to Other Federal Agencies

As authorized by statute, MMS also plans to transfer royalty production taken in kind to other government agencies for direct consumption by the Federal government. The Federal government's energy requirements are large and are in excess of its royalty share of oil and gas production.

While geography and logistics prevent efficient implementation in all locations where oil and gas are consumed, there are enormous opportunities to build energy supply relationships within the Federal government. These

Information  
Collection  
and  
Language

internal supply relationships have the potential to generate significant efficiencies and lower the total cost of energy consumed by the Federal government.

For onshore, the MLA provides in 30 U.S.C. 192 that the Secretary may offer RIK for sale "except whenever in his judgment it is desirable to retain the same for the use of the United States ...". The OCSLA provides more specific authority to the Secretary at 43 U.S.C. 1353(a)(3) to transfer RIK production to other Federal agencies as follows:

Title to any royalty, net profit share, or purchased oil or gas may be transferred, upon request, by the Secretary to the Secretary of Defense, to the Administrator of the General Services Administration, or to the Secretary of Energy, for disposal within the Federal Government.

We have already developed arrangements involving the transfer of crude oil to the Department of Energy for the Strategic Petroleum Reserve and transfers of natural gas to the General Services Administration for use as fuel in Federal facilities. MMS expects to continue to explore the potential and expand the direct, internal consumption of royalty oil and gas production taken in kind.

While adequate authority exists under existing statutes and leases to take the Government's royalty in kind, MMS believes it is in the interest of all to establish a common understanding of the framework within which the RIK program would operate.

The proposed regulatory framework is sufficiently flexible



to enable MMS to operate RIK pilot programs that could test approaches that are market-responsive, consistent with best industry practices, and minimally disruptive to lessees and operators. This rulemaking is proposed for that purpose, and we welcome comments from the public on any and all aspects of this rulemaking.

## **II. Section-by Section Analysis.**

### *Section 209.1      What is the purpose of this Part?*

This section would state that the purpose of this part is to set forth general guidelines that will apply when MMS elects to take the royalty in kind from an oil and gas lease. The section would make clear that the proposed new Part 209 would not apply to the program for sales of Federal royalty oil to eligible refiners under part 206 of 30 CFR.

### *Proposed Section 209.2      What definitions apply to this Part?*

This section of the proposed rule would explain the definitions that you will need to know for the new Part 209. However, other definitions in Chapter II of 30 CFR, which are not specifically defined in this proposed rule, and do not conflict with definitions in this proposed rule, also would apply.

Several of the proposed definitions are self-explanatory and some such as "Approved royalty meter" or "Contracting officer," are similar to the definitions for those terms

under other existing authorities. Others, such as "Competitive bidding" and "Notice of Availability" are new terms proposed specifically for purposes of this rulemaking.

Generally, care has been taken to propose definitions that would not unduly restrict MMS from participating in emerging markets; exploring different competitive processes, or utilizing new technologies that would facilitate efficient and effective management of RIK programs.

For example, the proposed new definition of "Competitive bidding" is very broadly drawn so that we would be able to choose from the widest array of bidding procedures and formats that prove to be the most efficient and most appropriate to a given sale. The term is defined as any procedure affording equal access to all qualified potential purchasers to submit an offer for the purchase of royalty production. It is intended that this definition would include traditional bidding formats as well as use of the latest in communications technologies common throughout industry.

A new definition of "Contracting Officer" is proposed because the purchaser of RIK production has a contract to purchase personal property from the Federal Government and such contracts are governed by the Contract Disputes Act of 1976 (CDA), 41 U.S.C. 601-13. The CDA requires that "[a]ll claims by the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer." 41 U.S.C. 605(a).

A proposed new definition of "Notice of availability" is offered to enable us to choose from alternative methods of announcing the availability of RIK production for sale. Notice of availability is proposed to mean the public announcement by MMS that it is offering royalty production for sale to the public.

In any situation involving the taking of RIK production, the managing operator of the property will be an active participant in the success of the transaction. Accordingly we are proposing a definition of "Operator" to make clear that the term for these purposes means any person, including a lessee, who has control of or who manages operations on an oil and gas lease site on Federal onshore lands or on the Outer Continental Shelf.

Because the MLA uses the term with respect to RIK onshore production, we have included a proposed definition of "Public Auction" to mean a competitive sale open to qualified persons of the public at which royalty production is sold in response to the highest or best bid.

The new term "Purchaser" is proposed for these purposes to mean any person who acquires production taken by MMS as royalty-in-kind and who has a contractual obligation under an agreement to purchase royalty production.

We are proposing the term "Royalty production" to refer to the royalty share to which the Federal government is entitled to take as a royalty in the form of physical volumes. Accordingly, "Royalty production" is being

proposed to mean that amount of oil, gas, or other products that MMS takes in-kind in partial or full satisfaction of a lessee's royalty or net profit share obligations as determined by whatever lease interest the lessee holds under an applicable mineral leasing law. Generally, royalty production equals that portion of production from or allocated to a Federal lease multiplied by that lease's royalty rate.

*Section 209.3      What leases are subject to this Part?*

This section explains that Part 209 applies to all Federal oil and gas leases both onshore and on the Outer Continental Shelf that give the lessor the exclusive right to take the royalty share of the leased production in kind.

*Section 209.4      What discretion does MMS have in electing to take royalty from Federal oil and gas leases in-kind?*

This section clarifies that the Secretary has complete authority to decide whether and for how long to take royalties in kind. This authority is provided by both statute and lease terms and accordingly is on a lease by lease basis.

*Section 209.5      If I am a lessee or operator, what notification will MMS give me that it will be taking its royalty production in-kind?*

Under this section, it is proposed that MMS would provide an affected lessee or operator with a 30-day prior written

notice before MMS would commence or terminate its taking of RIK production from a property.

We believe that, although there are no notification time requirements in either statute or lease terms, it would be fair to give Lessees prior notice of commencement and termination of taking production in kind from a lease, so as to minimize disruption to the Lessee's planning for transportation and sales of its share of the production stream. Many Lessees and Operators have informed MMS that a 30-day time period is equitable and also conforms to industry standards. MMS invites comment from the public as to the desirability of a 30-day notification period.

Further, the proposed section provides that, where MMS decides to take a lease's royalty production in kind, we will take all such royalty production from the lease in kind until MMS gives notice of when it will discontinue taking in kind.

Section 209.6      On what basis may MMS arrange to sell or dispose of production taken in kind?

This section explains that the Government proposes to dispose of mineral royalties through two methods: direct sale to the public and transfer within the Government. These are the two ways authorized by the MLA and the OCSLA.

Section 209.7      How do I find out about the availability of royalty production for sale to the public?

This section explains that public offerings of royalty production would be advertised in a publicly available notice. Over the past several years, MMS has found that use of its Internet Home Page is an effective means to rapidly disseminate information to the oil and gas industry and to the public at large. We will continue to use this communication method. MMS will also place public notices in industry trade journals, on commercial electronic bulletin boards, and other media.

*Section 209.8 Who may bid in a sale to the public?*

This section explains that, for royalty production offered to the public, any person would be permitted to bid if they are eligible under the terms and conditions specific to the particular bid offering at hand. The term person in this context, as defined in Section 209.2, would include individuals, corporations, private companies, joint ventures, or State Government agencies. Production transferred to Federal agencies for consumption by the Federal government would not be available for public sale.

*Section 209.9 In what physical condition must I as a lessee or operator tender the royalty production to the MMS?*

This section makes clear that royalty production delivered by a lessee or operator must be in a condition that would be accepted by a purchaser under a sales contract typical for the field or area. This has long been considered

an obligation imposed by the terms of Federal leases and is reflected in the royalty value regulations at 30 CFR Part 206 including the definition of "marketable condition" set forth at 30 CFR 206.151. It will continue to be the lessee's obligation to perform and bear all costs of gathering, dehydration, separation, compression, (sweetening) or other processes that MMS will require in connection with the delivery of RIK production.

*Section 209.10      When and at what frequency must royalty production be delivered to the Lessor?*

This section would make clear that the lessee or operator must deliver royalty production as it is produced and moved through the royalty meter, without interruption, unless specifically approved by MMS.

We are proposing that natural gas taken in kind must be delivered on a daily basis, unless other arrangements are approved by MMS. This is consistent with industry practice so that purchasers are able to make necessary transportation and other arrangements.

The proposed provision would recognize that in some cases, it may be necessary to delay delivery of crude oil for as long as a month to permit aggregation of saleable quantities of production from lower-producing properties. Allowance for less than daily delivery of natural gas is provided for, but only when specifically approved by MMS.

*Proposed 209.11      What volumetric and quality measurement requirements will apply when MMS takes its royalty production in-kind?*

We are proposing to use the same measurement and reporting standards applicable to the payment and reporting of royalties in value as prescribed in the existing regulations at 30 CFR 202 for RIK oil and gas. Please provide any comments you have on the standards to be used in measuring and reporting RIK production.

*Section 209.12      How long must I retain records of my dealings in royalty production?*

This section proposes to adopt the same records retention requirements applicable to royalties paid in value under 30 CFR 212.50 (1997). Lessees, operators or any other persons dealing in RIK production would be required to maintain all records pertaining to such production for a period of 6 years after the records are generated unless MMS notifies the record holder that a longer retention period is required.

*Section 209.13      How may I appeal MMS orders concerning royalty production?*

The appeal procedures proposed for MMS orders issued to lessees or operators would be in accordance with the current administrative procedures set forth in Parts 243 and 290 of 30 CFR. These are the procedures that have always applied



to appeals of MMS orders to calculate and pay percent of value royalties.

A major revision of these administrative appeal procedures is currently underway and MMS is evaluating public comments received in response to its Notice of Proposed Rulemaking currently pending and published at 64 FR 1930 (January 12, 1999). If adopted, those appeal procedures would be available to lessees and operators dealing in RIK production.

Those proposed rules also prescribe that if you are a purchaser or recipient of royalty production and you wish to appeal an order issued by a Contracting Officer concerning RIK production, you would have the option of appealing the order to the Board of Contract Appeals in the Office of Hearings and Appeals, Office of the Secretary, in accordance with the procedures provided in 43 CFR part 4, subpart C or you could file an action in the United States Court of Federal Claims.

#### **IV. Procedural Matters.**

[The following are included as to format; each matter will be reviewed and addressed as appropriate] ,

#### Regulatory Planning and Review (E.O. 12866)

This document is not a significant rule and is not subject to review by the Office of Management and Budget under Executive Order 12866.

This rule will not have an effect of \$100 million or more

on the economy. It will not adversely affect in a material way the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities.

#### Regulatory Flexibility Act

The Department of the Interior certifies that this document will not have a significant economic effect on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 et seq.).

#### Small Business Regulatory Enforcement Fairness Act (SBREFA).

This rule is not a major rule under 5 U.S.C. 804(2), the Small Business Regulatory Enforcement Fairness Act. This rule:

a. Does not have an annual effect on the economy of \$100 million or more. The maximum economic impact is estimated to be \$xx million.

b. Will not cause a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions.

c. Does not have significant adverse effects on competition, employment, investment, productivity, innovation, or the ability of U.S.-based enterprises to compete with foreign-based enterprises.

#### Takings (E.O. 12630)

In accordance with Executive Order 12630, the rule does not have a significant takings implication.

Federalism (E.O. 12612)

In accordance with Executive Order 12612, the rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

Civil Justice Reform (E.O. 12988)

In accordance with Executive Order 12988, the Office of the Solicitor has determined that this rule does not unduly burden the judicial system and meets the requirements of sections 3(a) and 3(b)(2) of the Order.

Paperwork Reduction Act

This regulation may require additional information collection approvals under the Paperwork Reduction Act of 1995. [Approval for three Information Collection Documents is underway]

Your comments are important. The Small Business and Agriculture Regulatory Enforcement Ombudsman and 10 Regional Fairness Boards were established to receive comments from small businesses about Federal agency enforcement actions. The Ombudsman will annually evaluate the enforcement activities and rate each agency's responsiveness to small business. If you wish to comment on the enforcement actions in this proposed rule, call 1-888-734-3247.

National Environmental Policy Act of 1969

This rule does not constitute a major Federal action significantly affecting the quality of the human

environment. A detailed statement under the National Environmental Policy Act of 1969 is not required.

Clarity of this regulation

Executive Order 12866 requires each agency to write regulations that are easy to understand. We invite your comments on how to make this rule easier to understand, including answers to questions such as the following:

- (1) Are the requirements in the rule clearly stated?
- (2) Does the rule contain technical language or jargon that interferes with its clarity?
- (3) Does the format of the rule (grouping and order of sections, use of headings, paragraphing, etc.) aid or reduce its clarity?
- (4) Would the rule be easier to understand if it were divided into more (but shorter) sections? (A "section" appears in bold type and is preceded by the symbol "§" and a number heading; for example "§ 202.555 How do I determine the royalty due on gas production?")
- (5) Is the description of the rule in the "Supplementary Information" section of this preamble helpful in understanding the rule?
- (6) What else could we do to make the rule easier to understand?

Send a copy of any comments that concern how we could make this rule easier to understand to: Office of Regulatory Affairs, Department of the Interior, Room 7229, 1849 C Street NW, Washington, DC 20240. You may also E-mail your

comments to this address: [Exsec@ios.doi.gov](mailto:Exsec@ios.doi.gov).

**List of subjects in 30 CFR Part 209.**

Continental shelf, Crude oil, Government contracts,  
Mineral royalties, Natural gas, Petroleum, Public  
lands--mineral resources, Reporting and record keeping  
requirements.

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Date  
Minerals Management

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Assistant Secretary - Land and

For the reasons set out in the preamble, a new Part is proposed to be added at 30 CFR Part 209 as follows:

**PART 209 -- ROYALTY IN KIND**

1. The authority citation for Part 209 reads as follows:

**AUTHORITY:**

5 U.S.C. 301 et seq.; 30 U.S.C. 181 et seq., 351 et seq., 1701 et seq.; 31 U.S.C. 9701; 41 U.S.C. 601 et seq.; 43 U.S.C. 1301 et seq., 1331 et seq., and 1801 et seq.

209.1 What is the purpose of this Part?

The purpose of this Part is to set forth general guidelines that will be followed when the Secretary of Interior through MMS elects to take the royalty under an oil and gas lease in-kind. This Part does not apply to the sale of Federal royalty oil to eligible refiners addressed at 30 CFR Part 208.

209.2 What definitions apply to this Part?

Approved royalty meter means the measurement device approved by the jurisdictional MMS or BLM authority for determining the volume of production removed from a lease.

BLM means the Bureau of Land Management of the Department of the Interior.

Competitive bidding means any procedure affording equal access to all qualified potential purchasers to submit an offer for the purchase of royalty production.

Contracting officer means the MMS Director, his or her delegate, or the person designated under a royalty production purchase contract.

MMS means the Minerals Management Service of the Department of the Interior.

Notice of availability means the public announcement by MMS that it is offering royalty production for sale to the public.

OCS means the Outer Continental Shelf, as defined in 43 U.S.C. 1331(a).

OCSLA means the Outer Continental Shelf Lands Act (43 U.S.C. 1331 et seq., as amended by 43 U.S.C. 1801 et seq.).

Operator means any person, including a lessee, who has control of or who manages operations on an oil and gas lease site on Federal onshore lands or on the OCS.

Person means any individual, corporation, private company, joint venture, State Government agency, or Federal Government agency.

Public auction means a competitive public sale at which royalty production is sold in response to the highest or best bid.

Purchaser means any person who acquires production taken by MMS as royalty in-kind and who has a contractual obligation under an agreement to purchase royalty production.

Royalty production means that amount of oil, gas, or other products that MMS takes in-kind in partial or full



satisfaction of a lessee's royalty or net profit share obligations as determined by whatever lease interest the lessee holds under an applicable mineral leasing law. Generally, royalty production equals that portion of production from or allocated to a Federal lease multiplied by that lease's royalty rate.

Secretary means the Secretary of the Interior

209.3 What leases are subject to this Part?

This Part applies to all Federal oil and gas leases onshore and on the OCS that provide for the Secretary to take royalty production in-kind.

209.4 What discretion does MMS have in electing to take royalty from Federal oil and gas leases in-kind?

Standard Federal oil and gas leases give the lessor an unconditional contractual right to elect to take the royalty share of leased production in-kind. MMS's discretionary decision to take or not take its royalty in-kind is therefore not subject to administrative appeal.

209.5 If I am a lessee or operator, what notification will MMS give me that it will be taking its royalty production in-kind?

a) MMS will give lessees and operators at least 30 days prior written notice of when it will begin taking royalty production in-kind from a property. Unless other

arrangements are made with the lessee or operator, MMS will begin taking the in-kind production on the first day of a calendar month.

b) Once MMS has commenced taking its royalty in-kind from a property, any new production from that property will also be taken in-kind without a 30 day notice. Once begun, MMS will continue taking all production from the property until MMS notifies the lessee or operator of when it will discontinue taking in-kind.

c) MMS will give lessees and operators at least 30 days prior written notice of when it will discontinue taking royalty production in-kind from a property. Unless other arrangements are made with the lessee or operator, MMS will discontinue taking production in-kind on the last day of a calendar month.

209.6 On what basis may MMS arrange to sell or dispose of production taken in kind?

(a) Direct Sale to the Public

The MMS may offer to the public and sell, by public advertisement and competitive bidding, any part of the oil and/or gas, or component products taken as royalty in-kind.

(b) Transfer for Disposal Within the Federal Government

The MMS may transfer any royalty production taken in-kind to the Secretary of Defense, to the Administrator of the General Services Administration, to the Secretary of Energy, or to any other Federal agency authorized to procure energy

supplies.

209.7 How do I find out about the availability of royalty production for sale to the public?

The MMS will advertise to the public by a notice of availability of royalty production for sale to the public.

209.8 Who may bid in a sale to the public?

Any person who is able to meet the terms and conditions prescribed in the notice of availability will be eligible to bid for royalty production in a sale to the public.

209.9 In what physical condition must I as a lessee or operator tender the royalty production to the MMS?

Royalty production must be delivered in a form that is sufficiently free from impurities and otherwise in a condition that it would be accepted by a purchaser under a sales contract typical for the field or area. The lessee or operator must perform any necessary gathering, dehydration, separation, compression, (sweetening) or other processes currently required to place production in marketable condition under regulations applicable to royalties under 30 CFR part 206 (1998) at no cost to the Lessor.

209.10 When and at what frequency must royalty production be delivered to the Lessor?

a) The Lessee or Operator must deliver royalty production

to Lessor or its purchaser or agent at the same frequency as it is produced and moved through the royalty meter.

b) For natural gas, Lessees or Operators must deliver royalty production daily, unless MMS approves a different frequency on a case-by-case basis.

c) For crude oil, the Lessee or Operator must deliver royalty production upon movement of production from the well or tank storage through the royalty meter into the pipeline or barge or truck outlet. Depending on the volume of production and Operator-controlled decisions on movement of crude oil from storage, this frequency may be daily, weekly, or even monthly for low-producing properties.

209.11 What volumetric and quality measurement requirements will apply when MMS takes its royalty production in-kind?

The MMS regulations at 30 CFR 202 will apply to the measurement of royalty production.

209.12 How long must I retain records of my dealings in royalty production?

All records pertaining to royalty production taken in-kind shall be maintained by a lessee, operator, or other person for 6 years after the records are generated unless the record holder is notified, in writing, that records must be maintained for a longer period. When an audit or investigation is underway, records shall be maintained until

the record holder is released by written notice of the obligation to maintain records.

209.13 How may I appeal MMS orders concerning royalty production?

a) If you are a lessee or operator, you may appeal an MMS order concerning royalty production in accordance with the regulations set forth in Parts 243 and 290 of 30 CFR.

b) If you are a purchaser or recipient of royalty production, orders concerning royalty production will be issued to you by a Contracting Officer which you may (i) appeal to the Board of Contract Appeals in the Office of Hearings and Appeals, Office of the Secretary, in accordance with the procedures provided in 43 CFR part 4, subpart C; or (ii) file an action in the United States Court of Federal Claims.